

# ATLANTA ECONOMIC REVIEW

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# THE ATLANTA ECONOMIC REVIEW

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## Authors and Articles

### STEPHEN PARANKA

*"Marketing Predictions from Consumer Attitudinal Data"*

A relationship has been shown between the amount of the consumer's income and the amount he will spend, but what he will buy and how much of it has long been one of the uncertainties in production plans, particularly for consumer durable goods. Consumer-attitude surveys have been developed, and are constantly being revised, as a means of determining this market "unknown."

Dr. Paranka's article, reprinted from the *Journal of Marketing*, is the result of a study comparing the predictions based on consumer-attitudinal surveys with actual sales occurrence. The author is Associate Professor of Marketing, School of Business Administration, Georgia State College of Business Administration.

### JOHN J. CLARK

*"The Variable Bank Account: A Hedge Against Inflation?"*

The declining purchasing power of the dollar is a matter of concern to all — to economists, financiers, corporation managers, and to the housewife who shops for the daily bread. Dr. Clark, Chairman of the Department of Economics, St. John's University, New York, approaches the inflation problem from two suggested procedures: (1) a variable bank account based upon an equities fund—i.e., depositors may buy into a common stock fund, and (2) index deposits and loans—i.e., linking bank deposits and loans to an index. The author recommends the latter approach as more desirable and as worthy of serious consideration and study.

Dr. Clark's article is condensed from part of a larger study on the savings bank industry in the United States.

### CLINTON H. WHITEHURST, JR.

*"Shipping Subsidies: A Lesson for Railroads in Retrospect"*

The implications of the Transportation Act of 1958, as it attempts to relieve the "railroad problem," are as yet speculative. Mr. Whitehurst, in suggesting possible effects of the railroad subsidy legislation, reviews some of the difficulties involved in subsidization as it has been applied to the American shipping industry, and summarizes some of the undesirable aspects of subsidy legislation in the transportation industry.

The author is a graduate student and part-time instructor of Transportation Economics at the University of Virginia.

### J. J. McDONOUGH

*"The Management Forum: The Responsibilities of a Business"*

Mr. McDonough, President of the Georgia Power Co., is an outstanding leader in public, civic, and corporate affairs. From a diversity of interests, a comprehensive background, and managerial leadership, he proposes that the success of a business is not measured by extraordinary production and efficient performance alone. The public makes additional demands, and the successful business must respond. Among these added responsibilities for a business is that of citizenship, which embraces many duties.

### WARREN A. WALKER

*"The Southeastern Corner"*

Mr. Walker's fifth article in the series "Industrial Potentials in the South" is concerned with the making of paint, especially water-thinned decorator paint. As the author points out, plant location is extremely important for this product, as it must be highly market oriented. The southeastern states produce much less of this type paint than they consume. Though the production of the paint does not demand high skills, an effective sales force is most important.

THE ATLANTA ECONOMIC REVIEW

# marketing predictions from consumer attitudinal data

Stephen Paranka

In the existing economic framework, the consumer has free choice of spending or saving and free choice of how to implement his spending or saving decision. Consumer income is generally accepted as a basis for anticipating consumer spending, but there are inherent difficulties in using income as the only basis for predicting sales.

One difficulty is the initial need to estimate income accurately, including actual income and the extent to which credit will be utilized. An estimate must also be made about the consumer allocation of income. Consumer behavior is influenced also by the consumer's willingness to buy, particularly the important purchases of consumer durable goods. One forecast for 1959 concluded: "Much depends on attitudes. It is too soon to judge whether the consumer will choose to devote his increased . . . income to replacing his car, appliances, or housefurnishings, or will decide to use it for some other purpose."<sup>1</sup>

The Board of Governors of the Federal Reserve System has long recognized the need for learning more about consumer attitudes. In 1944 the Federal Reserve System sponsored the pioneer survey of consumer finances to measure the distribution of liquid-asset holdings among the nation's consumer units and their attitudes toward the holdings.<sup>2</sup> Originally the Division of Program Surveys of the U. S. Department of Agriculture conducted the survey, but

since 1946 the project has been conducted by the Survey Research Center of the University of Michigan.

This article analyzes the usefulness of the Survey Research Center's data on consumer attitudes in marketing prediction. First, the data will be compared with actual sales results to indicate existing relationships. Then, past efforts to utilize the data in marketing prediction will be examined.

## PAST SURVEYS OF CONSUMER ATTITUDES

The theoretical usefulness of surveys of consumer attitudes in marketing prediction is to provide data for predicting consumer behavior. Analysis of the past record of such surveys should indicate their relative usefulness. Pertinent criteria are accuracy of the surveys in anticipating changes in the direction of consumer spending, and the magnitude of consumer expenditures for durable goods.

## Change-in-Direction Prediction of Total Sales of Consumer Durable Goods

Over-all results of the Survey Research Center to indicate change in direction of consumer expenditures have been of a mixed degree of success. The Center's consumer-attitudes index has paralleled closely total sales of consumer durable goods. A noteworthy achievement by the Center was the corresponding change of its index with sales of consumer durable goods in 1954 and 1955, contrary to the income movement. The income growth in 1954 was the slowest in years, yet consumer attitudes were measured as increasingly more favorable toward spending, and 1955 turned out to be a boom

Note: Dr. Paranka's article is reprinted from the *Journal of Marketing*, national quarterly publication of the American Marketing Association, Vol. 25, No. 1, July 1960, pp. 46-51.

1 "General Business Conditions," *First National City Bank Monthly Letter* (January, 1959), p. 3.

2 George Katona, *Psychological Analysis of Economic Behavior* (New York: McGraw-Hill Co., Inc., 1951), p. 306.

year. Then income in 1955 picked up rapidly, yet consumer attitudes leveled off, the consumer spending also leveled off in 1956. In each of the two years consumer behavior was opposite to the normally expected in relation to change in income. Both times, however, the Survey Research Center studies detected the change on the basis of consumer attitudinal data.<sup>3</sup>

The Survey Research Center has shown limited success in indicating change of direction of total sales of consumer durable goods. When compared with the actual change in sales three months after the survey was taken, the Center's forecast was correct nine times out of thirteen in the period of 1953 to 1958. Comparison of the Center's forecast with actual total sales of consumer durables more than three months after the survey was taken indicates a decreasing degree of success. The Center's forecast was correct seven times out of thirteen for a 6-month projection, and five times out of twelve for a 9-month projection, and four times out of twelve for a 12-month projection. It appears that the present structure of the index is limited to predicting sales change for the short run of a few months.

A fundamental test of the consumer-attitude index is its ability to predict ups and downs in the level of total sales of consumer durable goods. During the period of December, 1952, to October, 1958, there were six such changes. The index correctly predicted the approach of only two of these changes—the sales decline in June of 1953 and in June of 1957. Analysis of the remaining four changes shows that the index failed to “lead” in the prediction of change reported in *Business Week* as follows:

#### *Report of Survey Findings*

1. February, 1954, survey:  
“No matter how you read them the figures show that consumers intend to buy less in 1954 than they did in 1953 . . . add it all up, and you get a plain picture of a moderate decline in consumer buying.”<sup>4</sup>
2. October, 1955, survey:  
“He (the consumer) seems set, for the most part, to keep up the pace at which he has been going.”<sup>5</sup>
3. August, 1956, survey:  
“There is no mistaking a current zestlessness—a lack of what Survey Center analysts call ‘new incentives’ for buying.”<sup>6</sup>
4. June, 1958, survey:  
“Anyone hoping for a great burst of consumer buying in the next months will find little in the new data to shout about.”<sup>7</sup>

3 “Flat Tire on the Bandwagon,” *Business Week*, Vol. 1456 (July 27, 1957), p. 58.

4 “Three Measures of the Recession,” *Business Week*, Vol. 1281 (March 20, 1951), p. 25.

5 “No New Steam Here for a Boom,” *Business Week*, Vol. 1370 (December 3, 1955), p. 158.

6 “No Bounce in the Buying,” *Business Week*, Vol. 1415 (October 13, 1956), p. 171.

7 “The Steep Slide Grinds to a Halt,” *Business Week*, Vol. 1507 (July 19, 1958), p. 72.

#### *Actual Sales Result*

1. Sales of consumer durables rose very sharply in the quarter following the survey, and continued up for the rest of the year, making sales in 1954 much greater than in 1953.
2. There was a sharp drop in sales of consumer durable goods in the quarter following the survey.
3. Sales of consumer durable goods rose sharply in the quarter following the survey.
4. Sales of consumer durable goods rose significantly in the quarter following the survey.

Three of the four missed changes were upturns in sales. It becomes apparent that other factors, in addition to consumer attitudes, should be recognized as influential in stimulating consumer demand. George Katona explains as follows: “If at a given time survey indications are for widespread restraint in spending, and therefore business firms intensify their marketing efforts and change their products and prices so as to stimulate buying, it may happen that the predictions derived from the survey are not realized.”<sup>8</sup> Government action may also affect the sales pattern.

The Survey Research Center considers the consumer attitudes index to be in its experimental stage and subject to revision. In 1957 George Katona said, “Thus after ten years of intensive efforts, we are still at the beginning of our work.”<sup>9</sup> After further study, a different combination of attitudinal questions may be included in the index, providing a more accurate indicator of direction of consumer spending. At present equal weights are assigned to each attitudinal factor. Future research may reveal a basis for differential weighting of the attitudinal factors. There is also the possibility that a revision of the scaling process may prove to yield a more accurate index in the future.

#### *Change-in-Direction Predictions of Sales of Specific Consumer Durable Goods*

Past survey results have been more accurate in predicting change of direction of sales of specific consumer durable goods than the total sales of these goods. The record varies from relatively high accuracy in the case of predicting changes in sales direction of used cars, houses, and furniture to relatively low accuracy in the case of television sets and refrigerators, as shown in Table 1.

The interval of twelve months between Survey Research Center surveys in the past has probably tended to bring about less success in predicting the change in consumer expenditures for appliances. A study of major purchases revealed that as many as 45 per cent of buying plans were less than six months in length, with the planning period length-

8 George Katona and Eva Mueller, *Consumer Expectations 1953-1956* (Ann Arbor: University of Michigan, 1956), p. 8.

9 George Katona, “Consumer Buying Habits—Analysis of a Ten Year Study,” *The Commercial and Financial Chronicle*, Vol. 185 (March 14, 1957), p. 43.

**Table 1**  
**Consumer Plans to Purchase and Actual Purchases**  
**of Durable Goods in the Period 1948-1957<sup>a</sup>**  
*(Percentage distribution of spending units)*

	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957
New Cars:										
Planned .....	9.7	11.8	10.6	6.6	6.8	9.0	7.9	8.2	8.4	8.5
Actual .....	6.1	8.6	10.1	8.2	6.7	9.1	7.9	11.0	9.3	9
Used Cars:										
Planned .....	4.1	6.8	6.9	5.5	6.0	6.2	6.4	7.5	7.2	8.4
Actual .....	10.9	13.0	14.4	13.7	14.6	14.5	15.9	17.1	15.4	15
Other Selected Durable Goods:										
Planned .....	27.4	30.9	28.4	27.4	23.2	31.9	26.9	28.5	28.0	29.4
Actual .....	39.2	39.5	41.9	42.1	39.3	42.8	43.3	45.1	43.1	41
Washing Machines:										
Planned .....	3.0	2.7	3.0	3.5	1.9	3.7	3.6	5.3	6	6
Actual .....	6.0	5.1	6.4	5.7	5.5	6.5	8.3	8.4	9.2	8
Furniture:										
Planned .....	8.6	8.4	9.6	10.4	9.6	13.2	11.9	12.0	11	13
Actual .....	15.3	14.1	12.6	14.3	15.4	16.4	16.3	18.0	16.9	18
Refrigerators:										
Planned .....	6.2	5.7	6.0	6.6	5.5	7.0	4.1	4.5	5	5
Actual .....	10.8	13.1	13.4	11.7	8.2	8.7	6.3	7.7	7.2	6
Television:										
Planned .....	—	2.8	6.6	6.4	6.8	10.8	7.7	5.9	5	5
Actual .....	—	5.6	11.8	12.0	11.3	14.2	14.3	15.3	14.0	10
Houses:										
Planned .....	7.5	7.0	8.4	8.5	6.4	8.8	6.6	9.4	9.4	8.7
Actual .....	5.2	3.5	4.5	4.8	3.6	4.3	4.7	4.8	5	N.A.

<sup>a</sup> Data on planned purchases do not include undecided responses.  
Source: Federal Reserve Board, Federal Reserve Bulletin.

ening as the size of the purchase increases.<sup>10</sup> A 12-month interval also includes more non-random, unforeseen events which affect the accuracy of anticipations. In a shorter time period consumer plans will less likely be confronted with unforeseen events.

Jean Namias has cited the importance of also considering other consumer characteristics along with intentions to purchase as a basis for predicting actual purchases. In an analysis of Survey Research Center data, comparing specified intentions to purchase household durables with whether or not the purchase was actually made, she found that actual purchases were related to the following consumer characteristics: intentions to buy, income level, liquid assets, attitude toward financial position and market conditions, size of consumer's town or city, and family structure.<sup>11</sup>

#### Revision of Time Interval

These undesirable features of the 12-month interval were recognized as having affected past results, and the time interval is being revised. The Survey of Consumer Finances sponsored by the Federal Reserve System is being planned on an experimental basis to take place quarterly instead of annually.

Even more frequent is the *Newsweek* sponsored survey under the direction of the National Industrial Conference Board. This survey is conducted on a continuous basis throughout the year. Each week

a sample of consumers is interviewed by daily telephone calls from which weekly reports are prepared. Four or five of these weekly reports are then accumulated to yield a continuous monthly report. The questions asked in this survey are similar to those of the Survey Research Center: questions about general business conditions, buying plans for specific items, and demographic and economic characteristics. A distinctive feature of the Conference Board survey is the short-run duration of the projected questions, six months, except for vacation plans, which are based on a 1-year period. This shorter time period for projecting purchase plans closely resembles the actual consumer planning period as shown earlier.

#### Use of Attitudinal Data as a Supplemental Tool in Forecasting

The addition of consumer attitudinal data to economic considerations and the use of judgment has improved the accuracy of predicted changes in consumer behavior. Irving Schweiger, formerly an analyst for the Board of Governors of the Federal Reserve System, reported that this combination is superior to "majority" opinion forecasts, which do not consider the factor of consumer attitudes. Differences between forecasts utilizing consumer attitudinal data and typical opinion forecasts of consumer expenditures for durable goods and houses have been frequent; but Schweiger reported in 1956 that in no case to his knowledge has the former been the one in error. The value of consumer attitudinal data is stated by him as follows: "Since the end of the war, but especially since 1948, the survey has

<sup>10</sup> Robert Ferber, "The Role of Planning in Consumer Purchases of Durable Goods," *American Economic Review*, Vol. 44 (December, 1954), pp. 854-874 at 858.

<sup>11</sup> Jean Namias, "Intentions to Purchase Compared with Actual Purchases of Household Durables," *Journal of Marketing*, Vol. 24 (July, 1959), pp. 26-30 at p. 30.

contributed something of importance each year to a better understanding of prospective consumer behavior.<sup>12</sup>

The contribution made by the addition of consumer attitudinal data is disclosed by an analysis of Schweiger's forecasting procedure. First, data on buying plans were taken as the most basic indication of consumer demand. These data were assumed to give information concerning changes in the level of consumer demand and an approximate measure of magnitude of change. Then the data were refined by inspection of internal survey consistency and analysis of possible changes in environment that would affect consumer buying plans in the twelve month period. Thus far, the analysis had concentrated on determining a measure of consumer willingness to buy. Added to this was an analysis of economic factors which influence consumer ability to buy. The sum total of the analysis became Schweiger's basis for forecasting future consumer behavior.<sup>13</sup> This application of consumer attitudinal data is supported by George Katona's contention that his studies be used to supplement, not supplant, studies of economic factors, business trends, and governmental trends.<sup>14</sup>

How consumer attitudinal data can be used in combination with other variables in marketing prediction is also illustrated by Peter De Janosi's analysis of variables influencing the demand for new automobiles.<sup>15</sup> He includes eight variables in his analysis: (1) disposable income, (2) car ownership status, (3) financial well-being, (4) new-car purchase plans, (5) actual and expected earning rates, (6) age of the head of the spending unit, (7) marital status of the spending unit, and (8) size of the community. A multiple-regression equation of these variables then provides a basis for determining the probabilities that certain individuals will buy new cars.

#### Magnitude Predictions

Past Survey Research Center surveys of consumer attitudinal data, as shown in Table 1, have not generally predicted accurately magnitude of consumer expenditures for durable goods and housing. Success has been limited to accurate predictions of new-car sales in 1952, 1953, and 1954. George Katona has stated that buying plans should not be interpreted as a numerical forecast, but rather as an indicator of consumer's willingness to buy. An increase in frequency of plans to buy by consumers should be interpreted as a greater willingness to buy, and a decrease in the frequency of plans to buy represents

a reduced willingness to buy. He further indicates that the data are more satisfactory as a basis for predicting direction of consumer behavior than the magnitude. The *Newsweek* survey results, likewise, are not intended to be translated into the size of the actual or potential market.

Various problems exist in the path of forecasting magnitude of sales of specific durable goods from attitudinal data. There is the problem of plan fulfillment. As can be expected, not all buying plans are completed by the consumer. Another problem is the need to consider the effects of government and business sector action. In addition, the two inherent errors of all surveys are present, sampling and reporting errors.

One optimistic note is the possibility of using good judgment along with the survey data to predict the size of durable goods sales accurately. An outstanding example took place in 1953 when general forecast anticipation for automobile production was 5.0 to 5.7 million cars. Most of the forecasters estimated figures of 5.5 million or less. Armed with the results of consumer attitudinal studies, however, Schweiger reports that a forecast of 5.7 to 6.0 million cars was made. This forecast is believed to be the closest one to the actual production of 6.0 million automobiles in 1953.<sup>16</sup> More research is necessary, however, before the attitudinal data can be used for accurate quantitative prediction of sales of specific durable goods.

#### CONCLUSION

Consumer attitudinal data can be helpful in marketing prediction. Use of these data, however, should be tempered with recognition of their limitations. In the past, the predictive record of attitudinal data alone has been one of both successes and failures. The successes have been in paralleling the general direction of total sales of consumer durable goods and in indicating the sales direction of large durable purchases.

The past failures of these data have been: failure to predict most of the ups and downs in the sales of consumer durable goods, limited success in indicating accurately the sales direction of appliances, and a general inability to predict magnitude of sales of durable goods. Analysis of basic economic factors in combination with the attitudinal data has been shown to improve significantly the accuracy of the predictive record.

Revisions in the survey procedure have been made and are anticipated to continue. Two specific areas which are considered to require further study are the basis for computing the over-all consumer attitude index, and the basis for predicting magnitude of sales of specific durable goods. Further refinement of the attitudinal data will simultaneously increase their usefulness in marketing prediction.

12 Irving Schweiger, "Forecasting Short-Term Consumer Demand from Consumer Expectations," *Journal of Business*, Vol. 29 (April, 1956), pp. 90-100 at p. 98.

13 *Ibid.*, p. 95.

14 George Katona, "The Predictive Value of Data on Consumer Attitudes," in *Consumer Behavior*, L. H. Clark (editor), Vol. 2 (New York: New York University Press, 1955), p. 67.

15 Peter E. De Janosi, "Factors Influencing the Demand for New Automobiles," *Journal of Marketing*, Vol. 23 (April, 1959), pp. 412-418.

16 Schweiger, *op. cit.*, p. 99.

# THE VARIABLE BANK ACCOUNT: A Hedge Against Inflation?

John J. Clark

The post-World War II era has given birth to two fundamental issues for professional and public discussion; the cold war on the political side, and the related problem of inflation on the economic side. If we accept Senior's early admonition to economists, we may safely leave the discussion of the political issues to the politicians and historians. The inflation issue, however, falls well within the range of economic discussion.

On the subject of inflation, opinion among economists manifests little unanimity. Economists disagree on the nature of inflation, its sources, and the policies needed to deal with it. Some economists hold moderate price increases a necessary concomitant of growth. Others feel a two to three per cent annual price increase preferable to the under-employment which price stability may bring. The more pessimistic feel that inflation will not continue to creep but will in the predictable future run at a rate in excess of five to six per cent per annum.<sup>1</sup>

Whether we describe the present inflation as the result of an excess demand or of a cost push, on the fact of inflation there must be general agreement. The Consumer Price Index shows an upward trend in the price level since 1935. Financial institutions advocate this or that investment technique as a hedge against the falling value of money. Invest-

ment companies have undoubtedly profited from the growing public apprehension. Following on the success of the Teachers Insurance and Annuity Association — College Retirement Equities Fund experiment, insurance companies manifest a renewed interest in plans to reduce the erosion of policy values. Variable annuities currently occupy the center of the stage in this field.

One feature of the current financial literature on inflation stands out. The authors devote little time and less effort to the possibilities of protecting the some \$150 billion of savings deposits in mutual savings banks, shares in savings and loan associations, and time deposits in commercial banks against the consequences of price inflation.<sup>2</sup>

It is the purpose of this paper to examine critically two basic approaches to providing these deposits and shares with some measure of protection against the harmful effects of a rising price level and to indicate a tentative choice among the means at hand.

## THE EQUITIES VERSION OF A VARIABLE BANK ACCOUNT

Mutual savings banks appear ready to meet the problem of price inflation by offering their depositors an opportunity to buy into a common stock

1 See John P. Lewis, "The Problem of Price Stabilization: A Progress Report," and George H. Hilderbrand, "Economics by Negotiation," *American Economic Review, Papers and Proceedings*, XLIX (May, 1959), 309-321.

2 The \$150 billion in savings deposits as of December 31, 1959, were distributed as follows: \$34,900,000,000 in mutual savings banks, \$54,400,000,000 in savings and loan associations, and \$61,500,000,000 in commercial bank time deposits. Source: Equitable Savings and Loan Association, Brooklyn, New York.

fund. The *Report of the Special Committee on Savings Bank Services* of the National Association of Mutual Savings Banks, after bewailing the fact that "we are in danger of becoming a marginal business receiving those funds that are left over—funds that have not been handed to our competitors who have devised more appealing forms of thrift promotion," advises direct sales to the public of shares in savings bank investment funds and the establishment of a variable savings account consisting in part of a participation in an equities fund of fluctuating value.<sup>3</sup> The public would presumably receive from the savings banks the chance to deposit in an account tied in whole or in part to a common stock fund, which is actually a variant of the open-end investment company. A conservative application of the plan might require the depositor to maintain an equal sum on deposit in the regular accounts, thus assuring him of a balanced portfolio. The regular account would constitute the defensive portion of the portfolio; and the variable account resting on the equities base, the aggressive portion.

This approach to a variable bank account postulates a favorable correlation between stock prices and the cost of living. Chart I depicts the nature of the correlation between common stock prices and the cost of living. Chart II illustrates the over-all movement of common stock prices in the period under review. No basic changes in these trends have been recorded for the years since 1956.

#### The Value of Common Stock as an Inflation Hedge

The charts cited certainly substantiate the claim that an investment in common stocks over the period covered would have secured for the holder ample protection against the depreciating value of the dollar, assuming that the stocks were properly selected and diversified. However, our judgment itself must be qualified inasmuch as there are degrees of inflation. In a creeping inflation averaging two to three per cent per annum:

... workers will try to get even larger money wage increases, to compensate for higher prices. But this, in turn, will make prices rise faster and lead to demands for even larger wage increases. Every price increase sparks new and larger wage demands. Thus, creeping inflation picks up speed until it moves at an uncontrollable gallop.<sup>4</sup>

Dr. F. Cyril James, the Canadian Economist, studied inflationary hedges in Germany in the post-World War I period. He emerged with the disconcerting conclusion that the only hedge in a galloping inflation was the family-sized farm.<sup>5</sup>

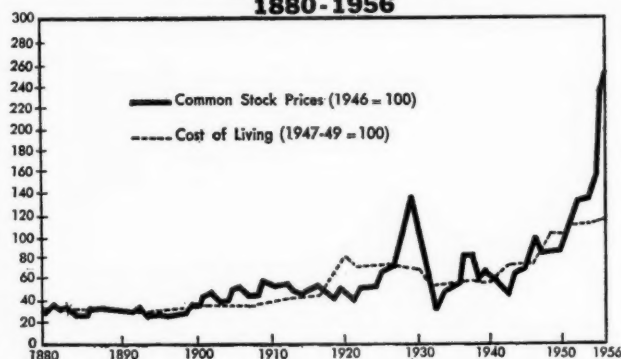
In the sale of stock to the public as part of a variable bank account scheme, it is desirable therefore to make explicit the assumption of creeping inflation. This type of inflation does not arise out of war-induced scarcity. On the contrary, it has its

<sup>3</sup> *Savings Bank Journal*, XXIX (December, 1958), 21, 42.

<sup>4</sup> T. W. Houser, *The Cruellest Tax*, Committee for Economic Development, July 23, 1958, p. 12.

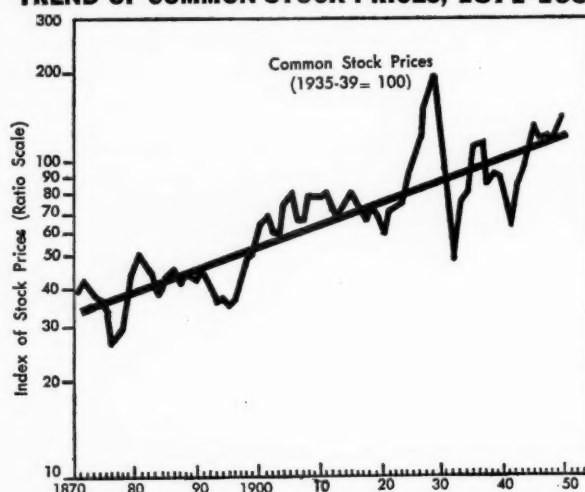
<sup>5</sup> *New York Times*, June 1, 1958.

Chart I  
INDICES OF COST OF LIVING  
AND  
COMMON STOCK PRICES  
1880-1956



Source: Cowles Commission Index, Standard & Poor's Index of 480 common, and Consumer Price Index. Reproduced from a technical memorandum on the variable annuity by Dr. Gordon MacKinley, Director of Economic and Investment Research of the Prudential Insurance Company of America.

Chart II  
TREND OF COMMON STOCK PRICES, 1871-1950



Source: Cowles Commission Index and Standard & Poor's Composite Index. See note, Chart I.

origins in fiscal and monetary policies or in the internal logic of an administered price structure.

Furthermore, the purchase of stocks *per se* does not assure protection against a rising price level. Rather, much more will depend upon the willingness of the security-conscious public to invest in possibilities. As Chart I indicates, during the last thirty years some of the greatest advances in stock prices have occurred in periods of relatively stable prices. The hedge value of common stocks will therefore depend upon the level at which the investor acquires his securities.

#### Problems Incurred

**Administrative.** A number of noticeable difficulties

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are associated with the introduction of a variable bank account based upon an equities fund, the success of which must rest upon the skill and insight of the portfolio manager. Dollar averaging and formula timing, however sound theoretically, are no substitutes for wisdom and experience in the field of common stock investments. The problems fall mainly on the small bank with limited funds to attract a good common stock man. The small mutual savings bank and savings association might find it impossible to promote an equities fund sufficiently large to warrant hiring personnel of the caliber necessitated by the plan. A possible solution lies in the organization of a central fund to handle common stock investments of the member banks. Indeed, the *Report of the Committee on Savings Banks Services* cited above anticipates the need to resort to a central fund device.

The fact that shares in a variable bank account are to be made available to a wider segment of the public than that currently attracted by the investment companies — presumably also a segment uninitiated in the vagaries of common stock investment—complicates the administrative problems. It is not difficult to envision a situation in which the fund's objectives would be vitiated or impaired by an influx or outflow of deposits following on waves of public optimism or pessimism regarding the future of common stock prices. This problem, inherent in the mutual investment technique, is aggravated by the proposed distribution of commons through a variable bank account to the general public. The volatile opinions of the public regarding investments could very well lead to an excessive turnover in the fund.

**Legal.** In addition to securing the assent of their respective state legislatures to the inauguration of a common stock fund (a point on which the savings bank industry can expect a stiff fight from the investment companies), the savings banks and associations can be reasonably certain that the Securities and Exchange Commission will assert jurisdiction over an equities version of the variable bank account. Mr. Robert Mehr's excellent analysis of the issues involved in the case of the *Securities and Exchange Commission v. Variable Annuity Life Insurance Company of America* in the September 1958 issue of the *Journal of Finance*, as well as the subsequent Supreme Court decision in that case, are opposite to our discussion of the variable bank account. The courts now hold the variable annuity resting on a common stock fund to be a security and not an insurance policy. The insurance companies thus face in this area the hazards of concurrent federal and state jurisdiction, which involve as yet many unexplored issues.

**Tax.** As in all matters financial, tax issues accompany any attempt to create a variable bank account. In the case of the equities version, the tax problem revolves around the question of whether the variable

bank account is or is not an integral part of the savings bank. Mutual savings banks, for example, are not subject to the federal income tax laws when their surplus and reserves exceed twelve per cent of the deposits. Except for the dividends on certain public utility preferred stocks, the tax law affects dividends up to fifteen per cent of the total received. Security profits fall under the capital gains sections. These provisions, of course, apply only to earnings not distributed to the depositors.

The concessions made here to the mutual savings banks are somewhat similar to the provisions of Regulation Q applying to investment companies. Unless the variable bank account were organized as an integral part of the banking operation, the savings banks would have to qualify the fund under Regulation Q, for otherwise it would suffer a tax disadvantage vis-a-vis the investment companies.

All these considerations, however, pertain to possible double or triple taxation on the same earnings. In any event, under the equities plan the depositor remains liable tax-wise for the dividends on his account as well as for the security profits, i.e., his share of the appreciation intended to protect him against a rising price level.

**Public Understanding.** The inauguration of an equities variable bank account faces some profound challenges as regards public understanding. The depositor stands the possibility of having his account shrink below its initial level. Therefore an educational job arises to convince depositors that the maintenance of fixed dollar assets involves equal risks. The bank, however, has to hurdle the traditional depositor psychology on this subject. Over their long history, the savings banks and associations have established a reputation for meeting their obligations in fixed dollars. Unless the savings banks and associations can reorient depositor-thinking about investment risks, bank tellers will face some interesting moments explaining the loss of principal below the amount deposited.

**Speculative Psychology.** The equities approach does have a minatory feature of encouraging the development of a speculative psychology by individuals least able to carry the attendant risks. It carries the possibility of a national numbers game, with life and financial security centering on the oscillations of stock prices. If past experience in the United States is any guide to the future, the depositors in an equities bank account should become rather stock-price conscious. Facing such a problem, banks likely would assume the herculean task of trying to convince depositors that their best interests call for a long term program of regular deposits in their accounts irrespective of the direction of the stock market at a given moment. More likely the plan would encounter speculative deposits and withdrawals as stock prices rise and fall.

Yet an equities approach to a variable bank account does have advantages in the light of Ameri-

can financial history. After obtaining permission of the respective state legislatures, the banks should find the plan fairly easy to initiate—that is, follow the well-tested mutual funds procedure. Furthermore, apart from possible damage to the reputation of the bank as stock prices decline, the plan does not contain features which under given conditions could precipitate failure of the bank itself, since the bank would have no fixed dollar obligation to the depositor. The obligation would be to liquidate the account at the net-asset value of the securities in the fund. The investment position would be transferred from the bank to the depositor. The latter would inherit the full appreciation or depreciation on his account. It is this appreciation potential, not the possibly higher yields, which makes the common stock a vehicle to outrun the declining value of the dollar.

#### INDEX DEPOSITS AND LOANS

Contrary to popular notion, the idea of linking bank deposits and loans to an index is not a new one, either in theory or practice. Indeed the proposal previously discussed is in effect a linking of deposits to an index of prices on a selected list of commons comprising the portfolio of the bank.

Index linkage of time deposits was initiated by the People's Republic of China in 1949, although subsequently abandoned. In France savings banks have opened special building savings accounts which are tied to a building-cost index. In Iceland the deposits of school children have been linked to an index. In Israel insurance companies and pension plans, making extensive use of the index clause, obtain the index compensations from the yields on index-tied bonds purchased by the companies.

Index linkage is not uncommon among bond issues. Index clause bond loans appeared in Israel in 1948; in China in 1950; in Finland, France, and Sweden in 1952; and in Austria in 1953. In 1956 Premier Guy Mollet of France announced that a new loan would be tied to the price of stocks and bonds on the Paris Bourse.<sup>6</sup>

#### The Finnish Experiment

Recognizing the truism that during inflation the borrower gains at the expense of the lender, the Joint Delegation of Financial Institutions in Finland took up the proposal of linking deposits to an index in order to protect the integrity of savings. As a result, the banking institutions of Finland offered to depositors an index-tied account from the beginning of May 1955 under the following plan:

1. Funds must be deposited for a period of at least twelve months.
2. A minimum deposit of 30,000 Finn marks is necessary.
3. The rate of interest on the index accounts is fixed at 1 to 1½ per cent below the customary rate on savings accounts.
4. Roughly, the index compensation to be paid the depositor will depend on the difference in the cost-of-living index at the time of deposit and the time of withdrawal.

5. Should the index fall below the level at the time of deposit, the principal sum would not be reduced.
6. In order to pay the index compensation to the holders of the index-tied deposits, the banks must collect proportionate amounts from their borrowers. Thus, all long-term loans as well as advances on current account are similarly tied to the index. Borrowers pay the index compensation in the form of an additional variable interest charge. Because of the prerequisites of participation in the plan, however, the index accounts under the Finnish plan constitute a relatively small proportion of total deposits. The borrowers therefore still apparently retain some net-benefit because the index increases in the cost of loans are spread over a much larger group of debtors.

At first the Finns offered two versions of an index account: **A Account**, offering 100 per cent index compensation but subject to income and property taxes; **B Account**, offering fifty per cent index compensation but exempt from taxation. The latter account was designed to appeal to individuals in a higher income bracket with a tax problem. It is currently the only account offered.<sup>7</sup>

*The Impact of Index Accounts on the Finnish Economy.* Index deposits grew very slowly during 1955 because of the stability of the cost of living index. However, the cost of living in Finland rose sharply in 1956, and, as a consequence, index deposits rose from month to month. The final figures on 1957 revealed an increase of sixty billion marks in the index accounts. In August of 1958 the index accounts reached their highest point of 91.5 millards, or 25 per cent of the total deposits in all banking institutions in Finland. From August 1958 to November 1958, as the threat of inflation eased, the Finns reduced their investment in the index accounts to some 76.8 millards.

While the index accounts declined slightly, the regular savings accounts staged a revival. During the first ten months of 1956, regular deposits decreased five billions; in 1957 there was an 800 million mark decline; but, in October of 1958, after some seven months of stability in the cost of living, the regular accounts registered an increase of 28 billion marks. The movement of the data illustrates one of the features of the Finnish system—namely, that public interest in the index feature wanes as price stability returns because of the lower rate of interest on the index accounts. With exception of a stable price level, the system ceases to operate because it has served its purpose.<sup>8</sup>

The Finnish banking officials feel that the index deposits have been successful in increasing savings during the period of greatest inflationary pressure. To that extent, indexation has had a salutary effect in contributing to price stability.

<sup>6</sup> Jussi Linnamo, "The Index-Clause Systems of the Money and Capital Markets," *Kansallis-Osake-Pankki (Economic Review)*, February, 1958.

<sup>7</sup> League of Finnish Savings Banks, *The Index Clause in Finnish Banking*.

<sup>8</sup> All figures from letters to the author of Nov. 8, 1958, and May 16, 1959, by League of Finnish Savings Banks.

### Advantages of Indexation in Savings Deposits

In the present position of the savings bank industry in the United States, a number of advantages would seem to accrue from the introduction of index deposits and loans:

**Improved Competitive Position.** Specifically, indexation possesses three advantages. First, it should attract the funds of those investors who now go elsewhere in search of a hedge against inflation. Also, it should secure for savings banks a larger share of long term savings, perhaps helping to reverse the present trend toward specific purpose saving. Finally, combined with a realistic adjustment of the limitations on the size of the accounts accepted by the savings banks, a variable bank account on an index basis should draw in funds from institutional investors, such as pension funds. Indexation strengthens the basket of services offered by the savings institutions to the public.

**Security for the Depositor.** Unlike the equities version of the variable bank account, the depositor cannot lose under the index system. In a period of rising prices, his account floats with the price level. *Pari passu*, his account declines in a period of falling prices but cannot sink below the amount initially deposited. The depositor avoids both the dollar price risk and the purchasing power risk of saving.

Under the equities version of the plan as already described, the depositor stands the chance of securing a greater appreciation in his savings if stock prices were to rise faster than the cost of living. Conversely, in the event of a falling stock market, the plan carries no limit to the loss of principal which may occur.

**Security for the Bank.** Under the index deposit scheme, the bank's liability to the depositor increases with the price level. The bank's assets, such as the index loans, also float with the price level. The relative position of the bank therefore remains unchanged. In effect, the bank becomes an agency to transfer the additional interest charges due to a rising index from the debtor to the depositor-creditor. The bank has no fixed liability to the depositor above the amount of his initial deposit. Under indexation, the savings banks would not assume any risks greater than those already carried.

**Ease of Administration.** The index accounts necessitate no major administrative overhaul in the banking system, merely the acceptance of an additional bookkeeping function. The computation of the index increases in the accounts is a routine effort with the adjustment in the individual bank account carried through in much the same fashion as dividends are now credited at the time of presentation of the depositor's passbook.

**Tax Problems.** In addition, the index account system possesses tax advantages. Regular interest on the index accounts would, of course, be taxable in the normal fashion. The index increases in the accounts,

however, do not fit present conceptions of either taxable income or capital gains. Apropos of the latter, in theory there could be no taxable gain because the whole purpose of the plan is to keep the depositor even with the price level. Thus the real position of the depositor remains unchanged. Although final status would have to wait upon specific rulings by taxing authorities, the index adjustment to the depositor's account does not appear to qualify as either income to the bank or to the depositor. As previously noted, under the equities version of the plan, the appreciation in the account qualifies as a capital gain and hence is taxable as such.

**Speculative Psychology.** The index-tied account, although perhaps lessening individual resistance to inflation, does little to encourage a speculative psychology. By balancing the dollar price risk and the purchasing power risk of saving, a great deal of the speculation is taken out of each. The depositor cannot be worse off than at the time of his initial deposit, and if the index were to fall below its level at that time, he might even gain some in terms of purchasing power. The plan offers the depositor little incentive to speculate on the fluctuations of the price level, because his position remains constant in "real terms."

**Public Understanding.** It would seem less difficult to educate the public to the advantages of the index-tied accounts inasmuch as it requires no revolutionary upheaval in public thinking about banks. The people are assured that their balances cannot fall below the amounts initially deposited. The additional step—having the balance above the deposited sums rise and fall with the price level—would not be novel to a people already familiar with index wage clauses in union contracts.

**Countercyclical Implications.** Under indexation the return to the depositor and the cost of funds to the borrower vary directly with the cycle, thereby producing a countercyclical effect. In a period of price increases, the possibility of having the dollar float with price level should enhance the propensity to save. Moreover, the index increases in the cost of funds to borrowers discourage the expansion of credit on the upside of the cycle. On the other hand, during the downside of the cycle, the incentive to accumulate funds in the index accounts evaporates while the cost of funds to borrowers declines.

### Obstacles to Indexation in the United States

Although the index-tied system of accounts does have distinct advantages, a number of major difficulties would hamper the adoption of the system in the United States.

The initiation of an index-tied system of deposits and loans will, on the face of it, constitute a difficult undertaking for the savings bank industry. The introduction of the plan solely by savings banks and associations, although it would attract new depositors, would tend to reduce the demand for funds

from the banks because of the potential index increases in the amounts borrowed. Furthermore, unless mortgage borrowers assumed the entire burden of the index increases, the index adjustments would have to spread to the investment portfolio. Ultimately, bonds and other securities would have to include the index feature. In Finland the central government and municipalities already issue securities with index clauses.

An equally difficult problem involves the complicated task of constructing an index for measuring fluctuations in the price level, and also the development of a formula to compute the index coefficients and a device to equalize the index increases in borrowed funds from bank to bank. The plan would necessitate general agreement among the state banking authorities on these points—a large order because of the decentralized and diverse character of the American banking system.

When the concept of index-tied deposits and loans becomes universally operative, long-term business planning becomes a hazardous job at best. The cost factor forever remains a source of concern since there is no limit to the possible interest increases on the index loans as the price level rises. Interest becomes a variable cost of production. Indexation could also create among borrowers an understandable desire to avoid future, indefinite index risks by transferring the burden of financing to the consumer through price increases. The businessmen in Finland favor outright large increases in interest rates compared to the uncertainties of the index system.<sup>9</sup>

**Author's Note:** The arguments, pro and con, on indexation of savings deposits apply *a fortiori* to all fixed income securities. I have restricted my treatment of the subject to savings deposits because of the current discussion here and abroad within the industry. By limiting the discussion in this fashion, we do not, however, reduce the number of areas open for further investigation. There is much material, for example, to be researched on indexation from the viewpoint of the borrower. An enterprising scholar might also examine the financial position of savings depositors—their debtor or creditor status—to evaluate net benefits of indexation to this group.

In broader perspective, the effect of indexation on the U.S. savings bond and on government fiscal policies offers a wide area for inquiry. Indexation of savings deposits would, of course, make government bonds less attractive to investors. This would compel the government to protect the purchasing power of its bonds either by adopting fiscal policies to stabilize the price level and hence make the index clauses inoperative or by adopting some form of indexation itself. Under our present arrangements, the federal government is in the enviable position of a borrower capable of influencing the value of money which he borrows and pays back. In fact, the government has every incentive to raise the level of national income by inflationary means and thereby ease the burden of heavy indebtedness.

Unfortunately, a part of this reduced ratio of debt to income . . . was a reflection of the inflation of the earlier post war years which brought about a significant decline in the purchasing power of the dollar. (W. Randolph Burgess, "The National Debt," a statement submitted to the Committee on Finance, United States Senate, July 29, 1957.)

Although attributing part of the improved debt-income ratio to the enhanced productivity of the national economy,

## CONCLUSION

A weighing of the evidence leads to the conclusion that the index-tied account presents ultimately the more desirable form of the innovation. Although the obstacles are many and great, since the need exists it is recommended that the industry study this direct approach to the variable bank account. Conversely, the equities version of the variable bank account utilizes one feature of common stock investment to sell protection against a rising price level. Also, it contains other features dangerous to the reputation of the banks and the security of the public.

With an awareness of advantages and disadvantages to indexation, it nevertheless appears feasible to advocate serious professional research on a plan to inaugurate index accounts on a limited scale by tying them in with new residential and commercial mortgages. The Finnish experience, as well as that of other nations cited in this article, has shown that, where indexation has been introduced, borrowers have usually accepted the system—although with some protest—if the alternative were no funds at all. Certainly for a nation which has manifested in the past a notable flexibility and ingenuity in financial affairs, the subject of a variable bank account should not trigger a negative response without some thoughtful investigation.

<sup>9</sup> T. Junnilla, "Finland Introduces the Index Clause in Deposit and Credit Business," *Kansallis-Osake-Pankki (Economic Review)*, April, 1955, pp. 177-179.

Undersecretary Burgess concluded:

*In this way we are gradually growing up to the debt, so that even though the dollar amount of the debt is not declining as much as we might wish, the debt still becomes somewhat less burdensome.*

The extant system thus offers little encouragement to fiscal discipline. Under indexation, cost of borrowing to the government would now vary directly, not inversely, with the price level.

The alternative form of the variable bank account, the equities version, also offers opportunities for fruitful research. I did not discuss, for example, the possible "pile on" effect of more and more funds bidding equity prices upward. It is precisely this "pile on" effect which constitutes one of the disadvantages to the equities version of the variable bank account. The risk here, however, may be more apparent than real. It does not seem altogether probable that a variable bank account with an equities base would alone precipitate a "pile on." The over-all demand and supply for equities must be considered. We cannot forecast at this point how much a variable bank account will contribute in net new funds to the equities market, for the innovation would partially replace present forms of equity investment.

On the supply side of the equities market, a New York Stock Exchange survey predicts that corporations will have to raise some \$150 billion to finance their capital needs in the period 1956 to 1965. (Revised New York Stock Exchange Estimate of Equity Capital Needs, 1956 to 1965.) In the view of G. Kieth Funston, president of the New York Stock Exchange, a shortage of equity funds, rather than an excess of demand, might constitute a limiting factor to the dynamic expansion of the American economy. (Address by G. Kieth Funston, Rollins College, Winter Park, Florida, February 26, 1956.)

# SHIPPING SUBSIDIES:

## *A Lesson for Railroads in Retrospect*

Clinton H. Whitehurst, Jr.

On August 12, 1958, the Congress passed a major amendment to the Interstate Commerce Act, the so-called Transportation Act of 1958. Its passage was hailed as an important step toward revitalizing the nation's rail system, and certainly the opening section of the act seemed to commend it to that end:

It is the purpose of this part to provide for assistance to common carriers by railroad subject to this Act to aid them in acquiring, constructing, or maintaining facilities and equipment for such purposes, and in such a manner, as to encourage the employment of labor and to foster the preservation and development of a national transportation system adequate to meet the needs of the commerce of the United States, of the postal service, and of the national defense.<sup>1</sup>

Less apparent, at a time when many railroads had been sustaining losses for several years, was the ultimate effect this legislation could be expected to have on the future development of the industry. Simply stated, the nation's railroads had become subsidized. What would happen now?

Thoughtful students of transportation cannot help but speculate on the outcome. At this early date no confident predictions concerning any particular aspect of this new railroad policy can be made. Yet, for those who entertain qualms and have specific reservations about the final success of this legislation, past experience under like circumstances is not altogether a poor guide.

This paper will examine some problems and implications for future policy which the Transportation Act of 1958, if allowed to become a cornerstone of government railroad policy, eventually will pose. These problems will be circumspectly studied by analyzing what occurred in another industry under approximately the same conditions and stimuli. That industry is American ocean shipping.<sup>2</sup>

### **Possible Approaches to the Railroad Dilemma**

Today, or more correctly yesterday, three alternatives were open to the Congress as approaches toward a solution of the "railroad problem."

(1) The first was an alternative only in the sense that it represented a continuance of pre-1958 conditions. The industry was heavily regulated by the Interstate Commerce Commission. Consolidations and mergers were time-consuming propositions, and with ultimate success highly problematic. Other forms of transportation, e.g., trucking and airlines, were exempt from paying a proportionate share of costs attributable to their operations, hence were in a more favorable competitive position. Economic literature, however, is replete with analyses and discussions of these conditions, and further description need not be given here.

(2) A second alternative was to loosen railroad regulation, relying mainly upon the courts to enforce the public good by application of existing anti-trust laws in the event the industry abused its newly found freedom. In conjunction with this policy an investigation would need be undertaken to determine a means of taxing other transport systems proportionate to the amount of use they enjoy from facilities largely maintained at public expense.

(3) The third alternative (and the one followed) was to accept existing conditions as desirable and

<sup>1</sup> U. S. Congress, Transportation Act of 1958, Public Law 85-625, 85th Cong., 1st Sess., 1958, Sec 501.

<sup>2</sup> For purposes of this article, the American ocean shipping industry was chosen as the compared industry for several reasons. First and foremost, American ocean shipping has already run the full course from initial construction loan aid to full operating and construction subsidies. There is no need to speculate on effect. Second, as is true of railroads, ocean shipping is of a service nature, transporting essentially the same type of revenue earners, i.e., space-occupying freight, bulk cargoes, passengers, and mail. However, they are noncompeting; hence there is little danger of constructing and contrasting two models put together from the same material. It might be noted that American coastwise shipping does compete with the railroads. However, this type of shipping is not subsidized under the various acts discussed in this paper. Finally, both shipping and railroads are considered important to the national defense. Arguments favoring subsidy on this ground will be generally similar.

grant a subsidy where necessary to support them. It is with this last alternative that this paper is primarily concerned; and, as suggested earlier, a start toward analyzing such a policy could well begin by tracing the progressive effects of subsidy legislation in another industry.

#### **Resume of Subsidy Legislation Concerning Ocean Shipping**

The rationale of The Merchant Marine Act of 1920 was to maintain a prosperous American ocean fleet in the face of stiffening foreign competition. Various arguments were used in its behalf, primarily the necessity of a strong merchant fleet in the event of war. Under this act a federal shipping board was authorized to determine what trade routes were essential to United States commerce and to offer to firms entering such a service government-owned vessels, either by sale or charter, on favorable terms. In addition, Section 11 of the act established a construction-loan fund, which is partly quoted below:

That during a period of five years from the enactment of this Act the board may annually set aside out of revenue from sales and operations a sum not exceeding \$25,000,000, to be known as its construction loan fund, to be used in aid of the construction of vessels of the best and most efficient type for the establishment and maintenance of service on steamship lines deemed desirable and necessary by the board, and such vessels shall be equipped with the most economical machinery and commercial appliances. The board shall use such fund to the extent required upon such terms as the board may prescribe to aid persons, citizens of the United States, in the construction by them in private shipyards in the United States of the foregoing class of vessels. . . .<sup>3</sup>

The Merchant Marine Act of 1920 did not appreciably aid declining American tonnage. Conditions worsened. In 1928 another act to aid shipping was passed. Its chief purpose was to increase and to define more explicitly the construction loan provision of the 1920 legislation. It was hoped, thus, to stimulate the private replacement of a growingly obsolescent fleet. This act, too, failed in its purpose, as the remarks of President Roosevelt to the Congress in 1936 bear witness:

In many instances in our history Congress has provided for various kinds of disguised subsidies to American shipping. . . .

I propose that we end this subterfuge. If the Congress decides that it will maintain a reasonably adequate American Merchant Marine, I believe that it can well afford honestly to call a subsidy by its right name.<sup>4</sup>

Mr. Roosevelt's plea was successful and the Merchant Marine Act of 1936 included provision for operating as well as construction subsidies.

The Merchant Marine Act of 1936 specified that shipowners receiving an operating subsidy must purchase their vessels from American yards. There was no option. At the time such legislation was written it was true that both shipping and shipbuilding

were hard pressed. However, it can be seen by a cursory inspection that the market has not treated them equally at all times since. From 1946 to 1948 shipping enjoyed a high degree of prosperity, while ship construction was down. In 1949 and 1950 both were somewhat depressed. From 1950 to 1955 shipping improved, while shipbuilding was consistently operating at far less than capacity. In 1957 shipbuilding picked up, with orders extending through 1965; world (and American) shipping recessed and considerable tonnage was idled.

Prior to the Merchant Marine Act of 1920 previous legislation had already established a shipping board with regulatory powers.<sup>5</sup> This legislation was amended in 1918, 1929, and 1933 and was finally replaced by the Act of 1936. Both the 1916 and 1920 legislation embodied a high degree of regulation for ocean shipping and, as noted, failed to check the relative decline of American tonnage.

The point of concern here, however, is not to prove that a transportation industry and its capital suppliers are continually at profit extremes; in most cases their fortunes probably do correlate well. The point being made is an objection to the tendency to justify a subsidy by a tie-in provision, i.e., aid to another industry, in the enabling legislation. The effects of such tie-in provisions can be seen by a second glance at the above example.

In 1957 American shipbuilding had entered into a boom period, largely through an increase in foreign orders. American shipping had begun a relative decline but was compelled to begin replacing its obsolete World War II type tonnage. However, the 1936 Act prevented subsidized lines from buying at the best terms obtainable in a world market. Purchases were restricted to the now very high-priced and inaccessible American yards.

#### **History of Rail Transportation Regulation**

Prior to 1920 railroads were regulated under provisions contained in the Act to Regulate Commerce of 1887 as amended by the Expediting Act of 1903, The Elkins Act of 1903, The Hepburn Act of 1906, The Munn Elkins Act of 1910, The District Court Jurisdiction Act of 1913, and The Valuation Act of 1913. The general tenor of this legislation was restrictive and highly regulatory. Section five of the original legislation absolutely forbade any type of "pooling" agreements, i.e., mergers.

From 1887 until 1920 the doctrine of enforced competition, coupled with excessive regulation, enjoyed the force of law. However, with the end of World War I and the return to private rail ownership, it became apparent that a need existed for new legislation. Rising prices coupled with the effects of policies instituted under government ownership were creating a serious drain on rail capital and credit.

<sup>3</sup> U. S. Congress, Merchant Marine Act of 1920, Public Law 205, 68th Cong., 1st Sess., 1920, Sec 11.

<sup>4</sup> U. S. Congress, Congressional Record, 74th Cong., 1st Sess., 1935, LXXIX, Part 3, 2859.

<sup>5</sup> U. S. Congress, Shipping Act of 1916, Public Law 260, 64th Cong., 2nd Sess., 1916.

The Transportation Act of 1920 generally extended federal supervision over rail operations but recognized that in some cases previous legislation was too restrictive. The prohibition against pooling agreements was repealed, and consolidations were permitted under terms laid down by the Interstate Commerce Commission. The rate structure was made more flexible. In general, it might be said that the 1920 Act marked a beginning of paternalistic concern by government for railroad welfare within a framework of well-defined regulations.

By 1920, then, though ocean shipping had reached the "construction-loan" stage of subsidy development, aid to railroads was still negative in nature, i.e., somewhat less-stringent and more flexible regulation. This "aid," however, proved insufficient to enable the railroads to weather the coming storm of the "thirties."

As the depression deepened, various bills and enactments to relieve an almost bankrupt system were brought forth. Most important were the loans made possible through the Reconstruction Finance Corporation.

In 1933 The Emergency Transportation Act was passed. This Act, among other changes, amended the Interstate Commerce Act in that it prevented rail consolidations by holding companies and made rail rates more dependent upon the concept of a "fair return." The kindest comment concerning the overall effect of this legislation is that results, insofar as improving rail financial conditions, were meager.

The last major rail enactment to be passed prior to 1958 was The Transportation Act of 1940. Its major provisions included modification of requirements for rail consolidation, although Commission approval was still mandatory; regulation by the Commission of water carriers (nonforeign); and a declaration of a national transportation policy.

In August of 1958 the most recent of rail legislation became law: The Transportation Act of 1958. It inaugurated into actuality the construction loan stage of subsidy development. Section 503 of the Act states:

In order to carry out the purpose declared in section 501, the Commission, upon terms and conditions prescribed by it and consistent with the provisions of this part, may guarantee in whole or in part any public or private financing institution, or trustee under a trust indenture or agreement for the benefit of the holders of any securities issued thereunder, by commitment to purchase, agreement to share losses, or otherwise, against loss of principal or interest on any loan, discount or advance, or on any commitment in connection therewith, which may be made, or which may have been made, for the purpose of aiding any common carrier by railroad subject to this Act in the financing or refinancing (1) of additions and betterments or other capital expenditures, made after January 1, 1957, or to reimburse the carrier for expenditures made from its own funds for such additions and betterments or other capital expenditures, or (2) of expenditures for the maintenance of property. . . .<sup>6</sup>

<sup>6</sup> U. S. Congress, Transportation Act of 1958, Public Law 85-625, 85th Cong., 1st Sess., 1958, Sec 503.

### Implications of the Railroad Subsidy—Based on the Experience of the Ocean Shipping Industry

Certain inferences seem clear from a review of the history of ocean-shipping and rail-transportation regulation and the established effects of the subsidy regulations on ocean shipping: primarily the political or noneconomic trend of thought that will guide legislation under certain economic conditions.

When a highly-regulated industry, whose existence is considered essential to national welfare, is in a state of decline, the political tendency is not to consider the possibility that the industry might become self-sustaining under minimum or less regulation, but to take the position that "all was done that could be done" and hence government subsidy is the only solution. Those holding this view fail to see the true relation between economic legislation and economic conditions. Either can be a cause or can be an effect (of the other).

Next to be considered is the modification of relations between the subsidized industry and its prime capital suppliers.

A main rationalization of those proposing a specific subsidy is that such help will aid not only the industry to be subsidized but also certain other industries as well. While there is no doubt that such reasoning is politically expedient, it is sometimes highly questionable as to whether it can be justified economically. What the proponents of the subsidy are saying is that the fortunes of two or more different industries (e.g., shipbuilders and shipping firms, and railroads and railroad equipment firms), selling different products or services in different markets, will vary in like manner under changing economic conditions. Statistics lend little support to this contention. American shipbuilders build for the world market, as does the General Motors Locomotive Division. The same would be true for other rail equipment suppliers. American shipping serves a world trade, rails serve an entire nation. Each pair of industries sells in a broad market, and there is no reason to suppose that their fortunes must change proportionately and in the same direction.

The second alternative railroad policy (in essence, less regulation) can now be contrasted to the present state of affairs. In such a comparison the cardinal point to be understood is that when a firm applies for government aid its potential size is limited in a large measure by provisions of the general legislation. There is never an attempt to provide particular legislation for a specific firm. The argument for the particular adapting to the general is usually made on the grounds of "fairness" and the need for treating all (firms) alike. However, in the long run the opposite generally proves to be the case. It is "unfair" to the unsubsidized firm, the subsidized firm, and the public.

When the Merchant Marine Act of 1936 became law there was no requirement that *all* ocean shipping firms of the class to be subsidized apply for aid.

The same is true for the present loan guaranties offered to railroads. The situation epitomizes the "fair-play" rationalization in that it supposedly allows the firm a free choice of "to be or not to be" subsidized. In practice the industry will divide into subsidized and nonsubsidized groups.

#### *Subsidized vs. Nonsubsidized Groups in Competition*

*Under depressed conditions the nonsubsidized firm will lose its share of the market.* Initially the unsubsidized firms will remain competitive, mainly because they are the strongest and less in need of aid. In time, however, they will be faced with the long-run effect of a law they chose to ignore. The chief result is that, as industry demand falls, they will be forced to cut costs and hence services. Their subsidized competition is guaranteed a return regardless of demand. The net result is that a larger share of the market will shift to the subsidized carrier since it can continue normal service even under depressed conditions.

*The nonsubsidized firm finds it more difficult to obtain capital than does the subsidized firm.* The financial market will treat the unaided firm as a highly speculative risk. In good times, faced with no government recapture of profits, the unsubsidized firm will yield a high return. The subsidized firm will be making a normal or slightly higher return. However, as demand falls, and should at the same time the unsubsidized firm require capital, it will be at high rate of interest or not at all.

Following passage of the 1936 Act, less than one-third of American ocean shipping was subsidized. Today every major line is subsidized or has applied for operating subsidy aid. The conclusion can only be: *In the long run there will be a tendency for weaker, less efficient firms, in becoming subsidized, to replace the stronger or the initially stronger.*

*The subsidized firm finds expansion difficult.* Assume that a particular subsidized firm wishes to expand its service, an expansion which if successful would make it less dependent upon government payments. What chance is there of this occurring? An actual example will illustrate the problem.

The Maritime Administration, acting under authority of the 1936 legislation, determined that four trade routes between the United States Atlantic coasts and the ocean coasts of Africa were essential as defined by the act. In 1946 four subsidized American lines<sup>7</sup> (in addition to foreign firms), operating on five subsidized routes, served this area. Thirteen years later there are still four subsidized lines. However, trade volume and trade patterns have changed: one subsidized firm transferred its ships to foreign flag, and another sold out entirely.

The following is an account of one subsidized firm's attempt to expand during this period.

Following World War II the American firm serving West Africa transferred its vessels to the Nor-

wegian flag. Two subsidized routes were thus open, one from the East coast and one from the Gulf. American South-African Lines, then serving the South and East African coasts from the United States East coast, applied for permission to operate on these two additional routes, thereby giving it a balanced African service. It received permission to operate on the East coast-West African service and was denied the Gulf route. The latter was awarded to a firm which until that time sailed exclusively to South America.

In 1957 the direct American competitor of American-South African on its South and East African routes sold out to a firm operating in the United States-North Europe-South America trade. No opportunity was afforded for the much smaller American-South African to expand its service, although the firm had been operating in that trade for over twenty-five years. The subsidy for this route went to the purchasing firm, which consequently re-established service on it. A fourth line maintained an American Gulf Coast-South African service throughout this period.

*Experience* in the African trade, insofar as subsidy awards are concerned, would seem to count for naught. In denying American-South African the right to expand in an instance in which there was no possible consideration of monopoly, and in enforcing competition by allowing a subsidy to become part of a sale, a general policy resting on two assumptions can be seen emerging.

The first of these is that competition between subsidized lines is desirable and a subsidized route, regardless of justification, is to be considered as continuing in perpetuity. Considerations neglected in formulating this policy include the facts that (1) American firms face competition on all routes from foreign carriers and (2) trade patterns change. In the African example above, there existed at the time a favorable<sup>8</sup> balance of trade between the United States and South and East Africa and an unfavorable balance between the United States and West Africa. Thus, comparatively little revenue was earned on outward sailings to West Africa, much on return; while much was earned outward to South and East Africa and relatively little homeward. A single firm, then, operating on all routes would have approximately balanced receipts earned from imports and exports, an essential condition for successful liner operation.

The above example can lead to only one conclusion. When absolute authority to determine firm size is vested in an administrative body, economic consideration will tend to be minimized, while the economic philosophy of a past or present government is paramount.

*A subsidy does not always appear to serve the*

<sup>7</sup> American-South African Lines (Farrell Lines), American West African Lines, Seas Shipping Company, and Lykes Lines.

<sup>8</sup> The term "favorable" as here used implies only that a shipping firm's receipts from exports exceeded those from imports. The mercantilist concept of the term was not intended.

public interest. A further point to consider is that of a subsidy's fairness to the public. If the public interest can be served without, or with less, government expense, can it be claimed that the public is benefited when the ultimate effect of a government policy is to burden the economy with an increasing or fixed subsidy bill?

#### *Transportation Subsidies and the National Defense*

The national defense argument for maintaining a transportation system is not without merit. The chief criticism would be that it is overdrawn. In essence, optimum national defense ability implies optimum use of resources. In a relative peacetime economy a free market is generally considered as the best means of rationing resources among various industrial and consumer wants. In wartime this is not necessarily the case, hence the justification for maintaining by subsidy some industries that have great utility in a national emergency. This does not imply, however, that the rationing accomplished by the market is 180 degrees out of phase with national defense needs. If, indeed, it is agreed that the market in general rations efficiently, it would seem sound to plan a defense policy oriented in this direction, supplementing by subsidies only where necessary. Assume, as in the case of railroads, that rail passenger service must be maintained because of wartime troop transportation requirements. Further, assume that passenger service is subsidized. Because of this, highway and air service will expand less and hence be less likely in a position to function as troop carriers. What is being pointed out is only the previously-mentioned contention that market allocation of resources is not necessarily incompatible with defense requirements and should be given serious consideration as a guide to national defense planning.

#### *Transportation Subsidies and Labor Relations*

The chief effect that subsidy has upon labor relations in a subsidized industry is that the "whipsaw" becomes a main weapon of unions to the detriment of the unsubsidized portion of the industry. The situation that subsidy presents is a natural for this type of union tactic since union agreements generally cover both subsidized and unsubsidized firms. In a prolonged dispute the subsidized firms will more quickly meet union demands since subsidy payments will absorb the additional costs. With the industry front once broken, unsubsidized carriers have little choice but to capitulate. The ultimate result is that the public loses through increased transportation charges and the fact that a larger part of the general revenue is now devoted to subsidy payments.

#### **Summary**

This paper has attempted to treat several of the many difficulties that attend the inauguration of subsidies for a transportation industry. No claim is made to complete coverage of every aspect of subsidy. The points discussed, purposely relevant to the

two industries under comparison, are summarized below.

1. The question of when a firm is exercising monopoly power to the public's loss can best be left to the courts. Regulatory bodies, guided by socio-economic philosophies and vested with wide discretionary authority, have proved poor judges of correct economic determinants of firm size.

2. When an essential, highly regulated industry has entered upon a period of decline, the tendency of legislatures is to subsidize rather than to consider the possibility that freer play of market forces might correct the difficulty.

3. Justifying a subsidy by a tie-in provision which will allegedly aid another industry is not economically acceptable. The possible ramifications of such a policy are endless.

4. Any legislation which divides an industry into subsidized and unsubsidized sectors must ultimately support the entire industry.

5. Subsidy legislation invariably has subscribed to the principle of enforced competition. This makes virtually hopeless the attempt of any subsidized firm to expand to an optimum size at which a normal return would be possible.

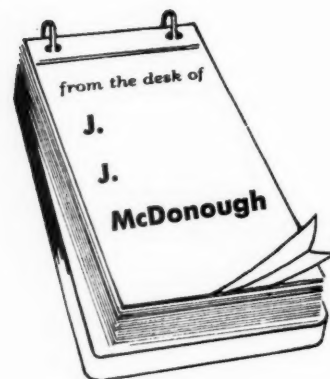
6. Extreme care should be used when justifying subsidies by use of the national defense argument. It is entirely possible that subsidizing a transportation industry might in the long run work to the detriment of national preparedness.

7. Subsidy legislation in a transportation industry can upset established bargaining practices between management and labor by splitting management into subsidized and unsubsidized groups. Labor becomes more powerful relative to the entire industry.

8. Implicit in all forms of subsidy legislation is the inherent movement toward socializing the entire industry. Control by so-called independent regulatory bodies is government control. Words, titles, or intent cannot change the fact. Today a federal maritime board directs the fortunes of the American ocean shipping industry. This fact cannot be wished away. As a pattern of subsidies develops in the railroad industry there is absolutely no reason to believe that the authority of the Interstate Commerce Commission will not increase substantially.

It is no longer valid to argue the question of whether railroads should or should not be subsidized. The first major step has already been taken, and it remains now only a question of degree. If the present trend continues, in due time the railroads will arrive at approximately the same position as has ocean shipping. The conclusions stated above are in themselves the best reasons for a reversal of the drift toward complete subsidization. Other alternatives within the framework of a free market have been shown to exist. They would seem to deserve consideration and a fair trial before being rejected as not in the best interest of the American economy.

# THE MANAGEMENT FORUM



## The Responsibilities of a Business

During recent years business in America has come in for considerable criticism, some of it justified, most of it not. Business has been criticized on the ground that it did not spread the rewards of labor widely enough, that it did not provide sufficient security for workers, that it did not contribute enough to the advancement of the people, and that it had various other shortcomings.

Even though unjustified, this criticism has affected public attitudes and made a difference in the operation of business and industry. Business has found that it was expected to assume new duties, responsibilities, and obligations. And today the very existence of a business often depends on whether or not it accepts these obligations.

The American people no longer are surprised or even satisfied with outstanding production and economic performance by business. They expect business to do more than fulfill their material wants. They expect it to satisfy a wide range of psychological and ethical desires as well. They measure a business not for its material performance alone, but also for its interest in people and the community, its work in charitable and other worthwhile causes, and its understanding and recognition of things they themselves think important.

NOTE: The Management Forum series is arranged by Dr. Francis J. Bridges, Department of Management, School of Business Administration of Georgia State College of Business Administration.

A business exists and prospers only with the approval of the people. Therefore, business, in order to do an effective job of winning public support, must live up to the many obligations expected of it.

What are these obligations? They may be classified under the four groups upon which business existence depends: its stockholders, its employees, its customers, and its public and community.

### STOCKHOLDERS

Every business, of course, has an obligation to its owners and stockholders to operate efficiently and profitably. The wealth of America was not created by unsuccessful business, but by successful business. And any successful business must earn enough to pay a return to its stockholders.

As a matter of justice and equity, money should be permitted to earn wages, just as labor is entitled to earn wages. To deny investment the opportunity for reward is to destroy incentive, just as denying labor the right to an adequate reward destroys the worker's incentive to produce.

To attract new capital, a business must first demonstrate its ability to earn money on its existing investment. A man with money to invest has an unlimited choice. He can put his money in government or municipal bonds, in real estate, in cotton or wheat, in manufacturing industries or retail business, or he can leave it in the savings bank.

One thing is certain. The investor is not going to put his money in a business that cannot make money.

THE ATLANTA ECONOMIC REVIEW

An unprofitable business cannot get new capital and it cannot expand its facilities. Neither can it contribute anything to the community nor toward a healthy, expanding economy. Rather, it becomes a drain upon the economic resources and good name of the community.

#### **EMPLOYEES**

What about the obligations of a business to its employees? No business can be a successful operation unless its relationship with its own people is mutually satisfactory. Too often in the past employers have thought of industrial relations solely in terms of wage rates. While it is important for a business to pay adequate wages, this is not the only consideration, nor is it even the most important one.

According to various surveys, employees attach more importance to job security than to wage rates or to any other single factor affecting their conditions of employment. Thus, the first obligation of a company to the employee is to provide as stable employment as possible. Seasonal shutdowns or fluctuations should be reduced to a minimum in the interest of job stability.

Opportunity for advancement is a very important consideration. Such opportunities should be offered, and employees should be encouraged to prepare themselves for promotions to better jobs. Vacancies in the higher ranks of the company should be filled from within the organization rather than from outside.

Working conditions should be made as satisfactory as circumstances permit, and opportunities for recreation and vacations should be provided.

It also is an important obligation of a business to keep its employees informed on company policies, operations, and other matters. An employee ignorant of these things is not a good employee. He will have no vital interest in his job; and, as a representative of the company meeting the public, he will prove a failure.

#### **CUSTOMERS**

The obligation of a business to its customers—to the people who buy its products or services—is the third classification of a company's responsibilities.

Because of the infinite variety of goods and services produced and sold to the American people under all sorts of conditions, it is difficult to make general statements which will cover all cases. It can be said, however, that the American standard of living has been produced by an economy of abundance—a supplying of goods in large quantities at a price which the people could afford to pay. And, of course, business has a duty to its customers to produce a quality product or service at a reasonable price.

#### **THE PUBLIC**

The obligation of a business to the public and to the community is the fourth classification of business responsibilities and covers the widest range of activities. Perhaps it would be best to call this ob-

ligation simply good citizenship, for every business, from the largest manufacturing plant to the smallest crossroads store, is a part of its state, its county, and its city, town, or village. In order to grow and prosper, a business—any business—depends upon the general prosperity and well-being of the area in which it is located. For this reason, it cannot be indifferent to the life of the community. It cannot avoid the responsibilities of citizenship without sacrificing some of the confidence and good will of the three other groups—its stockholders, its employees, and its customers—as well as that of the people of the community.

Business, therefore, has a direct responsibility of participating in activities that will improve the community and help it grow. Often this responsibility transcends mere participation, and on such occasions the obligation of undertaking leadership in the state, area, or community must be assumed by business.

A business should encourage its employees to take part in all constructive enterprises in the community, such as the work of civic clubs, chambers of commerce, garden clubs, church organizations, school groups, and others. It should encourage them to promote the work, as leaders or workers in the ranks, of the Community Chest, Red Cross, and similar charitable and philanthropic activities. A business concern should set the example by participating actively, through its top management, in such organizations.

Business has an obligation to improve the living conditions of the people in its own community. There are unlimited opportunities to help increase employment in manufacturing, agriculture, and retail trade; to improve the appearance of a town; to obtain better recreational facilities; and to promote more adequate public services such as schools, hospitals, fire protection, water service, street paving, libraries, and the like. These are the things that will determine whether the communities will grow and prosper or remain static.

A special interest should be taken in youth activities and education. All business needs youth. This is the source of a company's new employees, new customers, and new voters who can support or oppose matters affecting business enterprise. Business has a responsibility to the young people of the community to set the good example, to provide the guidance, to assist them in growing up to be good citizens, well-educated and law-abiding.

It also is the responsibility of business to maintain a line of communications with its stockholders, employees, customers, and the people of the community to keep them informed of social, political, and other activities affecting their mutual interests.

The obligations of a business to all four groups are thus interdependent. A company can hardly meet one obligation successfully without meeting all; nor can it fail in one without failing all.

# THE SOUTHEASTERN CORNER

## INDUSTRIAL POTENTIALS IN THE SOUTH PART V

Warren A. Walker



### WATER-THINNED DECORATOR PAINT

It has been suggested that, although the capital requirements for the production of many of the items named in this series of articles may be modest by some standards, they are, nonetheless, rather substantial amounts from the individual's point of view. A product will be considered this month that represents about as low an amount of initial fixed capital as any industry of which we have any knowledge. According to a survey conducted by the Georgia Institute of Technology,<sup>1</sup> a small plant for the production of water-thinned decorator paint might be placed in operation for under \$8,500.

A rather basic point of economics should be mentioned. As a general proposition, competition is directly proportional to the ease of entry into a particular business. An industry with capital requirements as low as that indicated above could properly be said to have the characteristic of "ease of entry." As will be pointed out later, there are other factors which may more than offset this feature.

As in the case of certain types of production of plastic items, almost unlimited technical assistance is available from the producers of the various raw materials used in paint making. This assistance amounts to a considerable reduction of engineering costs to the individual paint manufacturer. Under the minimum capital requirements previously mentioned, it is assumed that the colored pigment dispersions would be purchased from suppliers rather than manufactured in the plant.

#### Plant Location

Careful consideration must be given to plant location. Curiously enough, this factor may assume even greater importance for a small plant under certain conditions than it does for the multimillion dollar plant under other conditions.

For a favorable profit picture a paint-manufacturing plant must be strongly market-oriented. Because of the relatively high weight-to-value ratio and the somewhat special handling required, a ship-

<sup>1</sup> Industrial Development Branch, Engineering Experiment Station, Georgia Institute of Technology.

ment of even 500 miles can add from five to ten per cent to the retail price. This is one of the reasons why those well-capitalized companies that have national distribution and national advertising have found it desirable to adopt a policy of extensive decentralization. They would not be able to compete with even the lightly-capitalized producer under any other conditions.

The need for only moderately skilled personnel permits the plant to be located in an area which adjoins a large city rather than is actually in it. This means that the plant can enjoy a relatively low rent due to lower land values, and there is the additional advantage of less severe restrictions in the form of zoning regulations.

The survey previously cited indicates that within Georgia the most desirable locations are in the southwestern portions of the state in medium-sized towns such as Columbus, Albany, Thomasville, and Valdosta. The larger cities in other portions of the state already have plants that appear to have adequate production facilities for existing markets.

In the plant location analysis above, the paint making considered is oriented to decorator service, i.e., water-thinned interior paint. Oil-based paints, varnishes, and lacquers are somewhat different. They are not really competitive products except in a very general sort of way.

#### **Efficient Sales Management**

As stated earlier, technical assistance is available from the producers of the raw materials. The degree of skill required for production workers is not very high, and would be generally available. Figures indicate that the total cost of manufacturing in the area of wages and salaries is quite low, perhaps seven per cent of the invoice price of factory shipments.

The area in which skill is required is in the sales management. A weakness in this area could be fatal to the small local manufacturer even though he may have other factors in his favor. His competition will be brand names with national distribution and national advertising; and even though his competitors may not have a plant in the same city they may be sufficiently close so that the differential in transportation cost is rather low.

The local manufacturer cannot afford to think of his sales efforts in broad general terms. His sales force must be effective-selling individuals who take the view that "every dealer in their area is a prospect."

#### **Market**

Certain distribution trends can be distinguished. In 1954 the southeastern region produced only a little over two per cent of the national total, or about twelve million gallons, but in that year southeastern consumption was more than eight per cent of the national total. This means that nearly 75 per cent of the total southeastern consumption was brought in from other areas.

September 1960

There is considerable evidence that since that time the picture has undergone rather radical changes. Production in the southeastern states has doubled, or nearly so. On the other hand, consumption has risen considerably also. Taken on balance, the evidence is that the southeastern states still produce only about 50 per cent (or perhaps somewhat less) of their total consumption.

Based on the individual Development Branch estimates, the southeastern market has increased by 31 per cent in the aggregate, while the national total has increased by only 15 per cent. These figures include estimates of all existing markets. While the figures suggest that the southeastern states are, in the aggregate, a rapidly expanding market, the prospective manufacturer must keep in mind that for the most part his sales must be oriented strongly to a local market situation.

#### **Uses**

A rather large part of consumption of paints of the type under consideration is for repainting purposes. Purchases of paint for this type of use show a rather close relationship to the index of household incomes. Since this index has shown a favorable growth rate in the southeastern states, it may be assumed that the purchases of paint for this use have risen proportionally, although detailed confirmation is not available.

A second major area for consumption of paints of this type is new construction. During the period from 1948 to 1958 the southeastern states increased their percentage of new construction from 11.4 per cent of the national total to 13.1 per cent. From this it may be assumed that paint purchases for this use increased at least proportionally.

#### **Raw Materials**

The raw materials involved tend to sell for virtually the same price regardless of the scale of the purchases. Thus the small producer is at less disadvantage in this type of production than he is in many other types of manufacturing activities. This is especially true in view of the fact that the raw materials at times represent as much as 80 per cent of the manufacturing costs—a situation somewhat contrary to many manufacturing operations in which labor costs are the largest item involved in producing the goods for the consumer.

#### **INDUSTRIAL CONSUMPTION**

Industrial consumption is an area that has not previously been considered. The index of consumption for this purpose is in close correlation to both corporate profits and the number of production workers.

This is a somewhat specialized field in which the paint producer must constantly search for new contracts. It can be a profitable area of activity, but, as in the case of selling through dealers, an active, aggressive, and imaginative sales effort is required.

# June 1960

## ATLANTA AREA ECONOMIC INDICATORS

ITEM	June 1960	May 1960	% Change	June 1959	% Change	% Change six months '60 over six months '59
<b>EMPLOYMENT</b>						
Job Insurance (Unemployment) Payments -----	\$395,255	\$381,764	+3.5	\$322,645	+22.5	-5.3
Job Insurance Claimants -----	6,499	6,710	-3.1	5,299	+22.6	0.0*
Total Non-Ag. Employment -----	361,100	361,800r	-0.2	353,900r	+2.0	+2.8*
Manufacturing Employment -----	84,500	85,050	-0.6	86,050r	-1.8	-0.2*
Average Weekly Earnings, Factory Workers -----	\$81.80	\$82.19	-0.5	\$81.00r	+1.0	-0.6*
Average Weekly Hours, Factory Workers -----	39.9	39.9r	0.0	40.3	-1.0	-3.7*
Index of Help Wanted Ads (Seasonally adjusted, 1947-49 Avg.=100) -----	153.4	166.4	-7.8	189.4	-19.0	-2.4
<b>CONSTRUCTION</b>						
Number of Building Permits§ -----	738	989	-25.4	987	-25.2	-7.2
Value of Building Permits§ -----	\$8,159,268	\$11,941,621	-31.7	\$9,639,240	-15.3	-24.0
Employees -----	21,150	20,950r	+1.0	25,050r	-15.6	-10.1*
<b>FINANCIAL<sup>Δ</sup></b>						
Bank Debits (Millions) -----	\$2,152.6	\$2,103.7	+2.3	\$1,980.7	+8.7	+7.5
Bank Deposits (Millions) -----	\$1,269.3	\$1,248.3	+1.7	\$1,244.9	+2.0	+1.8**
<b>OTHER</b>						
Department Store Sales Index ----	169	171	-1.2	166r	+1.8	+4.1¶
Retail Food Price Index -----	117.6	116.8	+0.7	117.1	+0.4	0.0**
Number Telephones in Service ----	372,628	370,709	+0.5	359,560	+3.6	+9.7**
Consumer Price Index -----	127.1	126.7	+0.3	125.5	+1.3	+1.6

r—Revised

§City of Atlanta only.

\*Average month

N. A.—Not Available

\*\*End of period

ΔData from members of the Federal Reserve System only.

¶—Based on retail dollar amounts

Sources: All data on employment, unemployment, hours, and earnings: Employment Security Agency, Georgia Department of Labor; Number Help Wanted Ads: Atlanta Newspapers, Inc.; Building permits data: Office of the Building Inspector, Atlanta, Georgia; Financial data: Board of Governors, Federal Reserve System; Retail Food Price Index: U. S. Department of Labor; Department Store Sales Index: Federal Reserve Bank of Atlanta and Board of Governors, Federal Reserve System; Telephones in Service: Southern Bell Telephone and Telegraph Company.

# ATLANTA BUSINESS ACTIVITY

Total nonagricultural jobs in the Atlanta Area declined 700 from May to June, the bulk of the drop being recorded in durables manufacturing. This segment lost 550 workers, from 85,050 in May to 84,500 in June. Transportation equipment alone accounted for 400, due largely to an airline labor dispute. The June slump represents a continuation of the slow but steady decline in manufacturing activity which has been under way in this area since the first of the year. At present there are some 1,500 less workers in manufacturing than there were a year ago. In fact, by comparison with this year, 1959 looks better and better every month. In that year, nonagricultural employment rose by 9,450 workers the first 6 months, setting new records nearly every month.

The construction picture in Atlanta still seems mixed. On the one hand contract construction employment has had a nice steady upward drift since February, reaching the year's high of 21,150 workers in June. However, this is not as rosy as it appears when it is remembered that this time last year construction employment was setting a record high of 25,050 workers. Thus, despite the uptrend we are running 15-20 per cent below last year.

This does not come as too big a surprise when

we examine the behavior of the other two construction indicators. The value of building permits has been off last year's mark four months out of the six and is currently 24 per cent below last year's six month total. In addition, figures for July (not shown in the table opposite) show values to have dipped to \$5,268,775, which is only slightly above the year's lowest point on record. The other construction indicator, the number of building permits, shows a remarkably similar pattern, the number dropping 25 per cent from May and also running 25 per cent behind last year. Thus the construction recovery in the Atlanta area, so long anticipated, does not seem to have arrived yet.

Despite the weak manufacturing pattern, average weekly hours worked have held up well at about 39-40 for the year. Again, though, a comparison with last year reveals the weakness; every month is below its '59 mark (the average for the January through June period being about four per cent below that for last year). Average weekly earnings are on a par with last year and appear to be holding reasonably steady.

A good clue to the slackening job opportunities around Atlanta is seen in the index of help wanted ads. Off 8 per cent from May, they are now running 19 per cent below this time last year.

Bank debits, which seem to continue grinding upward, fair weather or foul, set a year's record in June of over \$2 billion. This figure has been topped only once (December 1959) in the city's history, and it plainly indicates that, despite sagging employment, total spending is still holding up well.

As a final note, Southern Bell reports that, as of June, Atlanta had a record number of 372,628 telephones in service. Since this indicator was begun in 1952 the number of telephones has failed on only three occasions to show a monthly net increase.

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For a company that has a product or service to sell, good salesmen are essential. In recent years the use of psychological tests in selecting salesmen has become more widespread. Dr. Ehlers' paper is a survey of the extent of use of psychological tests in salesman-selection by southern firms and the various testing practices followed. The study also sets forth the characteristics of users of tests as compared to those of nonusers.

Dr. Ehlers is Professor of Marketing, School of Business Administration, Georgia State College of Business Administration.

### BULLETIN NUMBER 9

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#### **An Econometric Model of the American Minor Cycle**

... George J. Malanos  
Henry Thomassen

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The purpose of this study, as stated by the authors, is: "To construct a system of equations which will predict as much as one year in advance, and with a precision that is acceptable for policy-making, the quarterly magnitudes of American aggregate employment and gross national product." In their conclusions the authors signified that, for the 1947-57 period and in the absence of a Juglar cycle, it was their "concerted opinion that the chief cyclical variation has originated with spending upon consumers' durables."

The authors are on the faculty of the School of

Business Administration of Georgia State College of Business Administration. Dr. Malanos is Professor of Economics and Chairman of the Department of Economics, Finance and Statistics. Dr. Thomassen is Associate Professor of Economics.

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U.S. public housing from its infancy has had a troubled career. The zeal of its proponents and the equal fervor of its opposition have met time and again in the legislative arena. This monograph traces the history of the development of the U.S. public housing program from 1933, the beginning of federal participation, to 1956. In the concluding section the author summarizes leading criticisms made by adversaries of the program; lists suggestions of housing experts on how to break the "dreary deadlock" of public housing; and suggests some of the factors to be considered in the future course of low-rent housing.

Dr. Brown is the Ben J. Massell Professor of Real Estate, School of Business Administration, Georgia State College of Business Administration.

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Compiled under the direction of J. H. Lemly, Professor of Transportation and Public Utilities, School of Business Administration of Georgia State College of Business Administration.

*For copies of the studies named above, send requests to the Bureau of Business and Economic Research, School of Business Administration of Georgia State College of Business Administration, 33 Gilmer Street, S. E., Atlanta 3, Georgia.*